

The seller of a special machine, tool, die, jig, pattern, gauge or other similar item is engaged primarily in a service occupation, rather than in the business of selling tangible personal property, and so incurs liability under the Service Occupation and Service Use Tax Acts with respect to the sale if the special order tests set out in 86 Ill. Adm. Code 130.2115(b)(1) are all met in the transaction. (This is a PLR).

August 4, 2000

Dear Xxxxxi:

This Private Letter Ruling, issued pursuant to 2 Ill. Adm. Code 1200 (see enclosed), is in response to your letter of July 2, 1999 and your supplemental correspondence of December 6, 1999 and June 30, 2000. This latter correspondence included documents containing information we had earlier requested regarding your ruling request. Review of your request for a Private Letter Ruling as comprised of your July 2 and December 6, 1999 and June 30, 2000 submissions disclosed that all information described in paragraphs 1 through 8 of subsection (b) of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to COMPANY for the issue or issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that neither COMPANY nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

In your letter, you have stated and made inquiry as follows:

This is a request for a private letter ruling under the provisions of 2 Illinois Administrative Code Section 1200.110 on behalf of COMPANY. A power of attorney is attached.

FACTS:

1. COMPANY, is a public utility supplier of electricity and natural gas located in CITY, Illinois. COMPANY operates a nuclear power plant located at CITY, Illinois. The PLANT is operated under a license granted by the Nuclear Regulatory Commission (NRC).
2. COMPANY is presently under audit by the Illinois Department of Revenue, there is no pending litigation with the Department. The subject of this ruling letter request is not an issue in the audit.
3. This request is intended to provide guidance to COMPANY, and its supplier BUSINESS regarding the payment of Use Tax and Service Occupation Tax.
4. COMPANY has not previously requested nor withdrawn a request for a private letter ruling from the Department on the subject of this letter.

5. COMPANY has contracted with BUSINESS to design, fabricate and install a 'Static VAR Compensator' system to enable COMPANY to operate reactor cooling pumps in any possible 'degraded voltage' condition or environment.
6. COMPANY is required by the NRC to demonstrate that it is able to operate reactor-cooling pumps in time of emergency. The Degraded Voltage Project will enable COMPANY to meet this requirement even in the event that its own generators at the PLANT go off line during a period of high peak electricity demand, such as a hot summer day. COMPANY intends to use the Static VAR Compensator to meet the requirements.
7. The Static VAR Compensator system is essentially a high speed (a 60th of a second) voltage control system which will insure that reactor cooling pumps will start when needed and will not stall. Static VAR Compensator concept and equipment has been used commercially in heavy industries such as the steel industry where very large power fluctuations must be controlled. The system being installed at COMPANY is unique to the nuclear power industry. COMPANY will be the first nuclear utility to use the system. It is being designed to meet the specific power requirements at the PLANT and the stringent regulatory requirements and specifications of the NRC.
8. The system will have no use or value, other than salvage value, to other persons since it is designed to the specific needs of COMPANY. Any transfer of the equipment would require that the system be dismantled, removed from foundations, and separated from the station power supply and transmission power supply. The system as designed has no known application for other persons.
9. COMPANY believes that the system is being provided to it in the course of a service transaction, not a retail sale.
10. When installed, the system will resemble an outdoor electrical substation. It will occupy a fenced site approximately 100 feet by 50 feet. Some of the equipment will be mounted on metal stands outdoors while other equipment and control systems will be installed in a control building with dimensions of approximately 30 feet by 15 feet. The major elements of the system are very large electrical valves, capacitors, circuit breakers, transformers and power supplies. In addition there are control systems and software, cooling and fire protection systems, and the building and site improvements.

TAXPAYER'S POSITION

COMPANY has retained BUSINESS to be responsible for the engineering, design, fabrication and installation of the project. Certain components of the project are obtained from other vendors or will be sub-contracted. There is no 'off the shelf'

availability, BUSINESS must design and fabricate the system. BUSINESS will purchase and incorporate into the system, some components that are stock or standard items. BUSINESS will itself produce other items for the system. The issue of whether the Service Occupation Tax applies to the overall production of a system rather than a specific tool, machine or object is addressed by case law.

In Velten & Pulver, Inc. v. Department of Revenue, 29 Ill2d 524, 194 NE2d 253 (1963), The Illinois Supreme Court examined a serviceman who produced special bakery conveyor systems. The Court found that the plaintiff did not hold itself out as a mere vendor of bakery equipment, but to the contrary it advertised as a specialist in bakery engineering who was subject to the Service Occupation Tax rather than the Retailers' Occupation Tax. Even though many of the items incorporated into the conveyor system may have been stock or standard in nature the overall system qualified for special order treatment. Every conveyor system was constructed upon special order and only after preliminary drawings and detailed plans had been formulated and prepared for each integral part by qualified engineers over a period of many months. It appears that a specially designed bakery conveyor system is an intricate combination of various mechanical devices and equipment which are designed to work harmoniously in transporting the products through the entire baking process carried on at various points throughout the plant. No two systems are identical, and although the motors could possibly be reset for a different operation, the engineering work involved in coordinating this equipment would be applicable only to the installation for which it is planned. The bakery equipment, when installed, had value, other than salvage, only to the purchaser for the specific purpose for which it was designed, and that the machine was useless for any purpose. The various bakeries, in contacting plaintiff, were not interested in purchasing motors, belts, switches, and other conveyor mechanisms but were concerned with engaging plaintiff's skill in devising a means for the moving of its products throughout its existing plant facilities.

In Commonwealth Edison Company and Westinghouse Electric Corporation v. The Department of Revenue 179 IllApp3d 968, 535 NE2d 30 (1989) a utility company that contracted for the design, manufacture, and installation of generators for two of its nuclear power stations was liable for service use tax on the specially designed generators because the generators were acquired incident to the primary purchase of engineering and other scientific services. The Department of Revenue argued that the transactions were taxable under the higher use tax rate because the turbine-generators were composed of standard components and these components had a use or value to other utility companies. However, the court concluded that the turbines were designed with a unique blade path based on the taxpayer's specifications. Thus, the turbine-generators had use or value only for the specific purposes for which they were produced.

In Kellogg Switchboard and Supply Corporation v. Department of Revenue. 14 Ill2d 434, 153 NE2d 45 (1958) the Illinois Supreme Court ruled that a switchboard that was not carried in stock did not qualify as special order. Upon receipt of the order, the plaintiff

set about fabricating the various 'patented' relays and circuits and incorporating them into a switchboard. Many of the relays are not stocked as such due to the lack of volume in their sale. However, the switchboard was constructed of stock parts, patented circuits and relays and jacks, together with other equipment designed, fabricated, or acquired by plaintiff, assembled into one unit and adapted to the system into which it must operate. To be sold to another customer, if found, it would probably have to be modified or readapted, or if unsold it would be disassembled and the various parts placed in stock until needed for the composition of another unit. The switchboard was a 'standard' Master Built Switchboard, and the plaintiff advertises the standardization of its switchboard equipment. It is true that 94 per cent of the component parts of this board were fabricated after receipt of the order, but it appears from the evidence that this procedure resulted from lack of volume in sales, and to facilitate the adaptation of the component parts to an existing system. It did not appear that these components were specifically and individually designed and engineered for Jerseyville alone. Plaintiff did little more than any manufacturer who assembles low volume production only upon receipt of orders.

Clearly the Courts have considered the question of whether a system comprised of standard components can qualify for taxation under the Service Occupation Tax rather than the Retailers' Occupation Tax. They have answered that question in the affirmative. Only in instances such as 'Kellog' where the switchboard was constructed almost entirely of stock or standard parts have they found that a system would not qualify for special order treatment.

In this project, COMPANY has retained BUSINESS to produce a highly specialized, even unique, system to meet its particular requirements. The system is produced on special order by a world recognized engineering and fabrication firm. Many of the components are designed and built specifically for this application. The system has no other application for any other person other than salvage value.

AUTHORITY:

1. Illinois Regulation, Section 130.2115. Sellers of Machinery, Tools and the Like.
2. Illinois Private Letter Ruling, ST 97-0016. Illinois Department of Revenue, July 14, 1997. Numerous other letter rulings from the Department of Revenue address specific fact situations of specific taxpayers. To the best of our knowledge, none of the recent letter rulings are adverse to the position of COMPANY.
3. Prairie Tank & Construction v. The Department of Revenue, 49 IllApp3d 291, 364 NE2d 963 (1977)
4. Commonwealth Edison Company and Westinghouse Electric Corporation v. The Department of Revenue of the State of Illinois, J. Thomas Johnson, Director of

Revenue of the State of Illinois, and James H. Donnewald, Treasurer of the State of Illinois. 179 IllApp3d 968, 535 NE2d 30 (1989)

5. Kellogg Switchboard and Supply Corporation v. Department of Revenue. 14 Ill2d 434, 153 NE2d 45 (1958)
6. Bucyrus-Erie Company v. Lorenz et al., 26 Ill2d 183, 186 NE2d 250 (1962)
7. Caterpillar Tractor Co. v. Department of Revenue, 29 Ill2d 564, 194 NE2d 257 (1963)
8. Velten & Pulver, Inc. v. Department of Revenue, 29 Ill2d 524, 194 NE2d 253 (1963)
9. Caterpillar Tractor Co. v. Department of Revenue, 32 Ill2d 377, 205 NE2d 447 (1965)
10. Marion Power Shovel Company, Inc. v. Department of Revenue, 42 Ill2d 13, 244 NE2d 598 (1969)
11. J. H. Walters & Co. v. The Department of Revenue et al., 44 Ill2d 95, 254 NE2d 485 (1965)

RULING REQUESTED

COMPANY, requests that the Illinois Department of Revenue issue a Private Letter Ruling to the effect that the Static VAR Compensator System will qualify for taxation under the Service Occupation Tax.

If you anticipate issuing a Private Ruling Letter which does not agree with the ruling requested, I would appreciate the opportunity to meet with you to discuss the issues in greater detail before a ruling is issued. I request that the names of the parties be deleted from any public publication of the letter and that all documentation submitted with the letter be held as confidential information.

Please call me at ##### if you have any questions.

As we communicated to you after receipt of your ruling request, we could not issue this Private Letter Ruling until we received additional documentation about what exactly BUSINESS is doing for COMPANY in the transaction that is the subject of your inquiry. The documents we received on December 10, 1999 and especially on July 5, 2000 are very illuminating as they provide much information that is not mentioned in the description in your original letter. These documents include, among other things, a comprehensive project plan to provide modifications to correct degraded voltage problems at COMPANY'S PLANT, BUSINESS design and hardware supply scope,

BUSINESS's organizational hierarchy chart for the CITY project showing the engineers working thereon, and BUSINESS's System Description of the CITY project.

The question of whether transactions are retail sales subject to the Retailers' Occupation and Use Taxes or are sales of service subject to liability under the Service Occupation and Service Use Tax Acts depends in part upon characteristics of the items being produced and the extent to which the vendor has engaged in the design of such items. As you are aware, 86 Ill. Adm. Code 130.2115, Sellers of Machinery, Tools and the Like, provides guidance regarding whether sellers of a special machine, tool, die, jig, pattern, gauge or other similar item are engaged primarily in a service transaction or retail sale. Subsection (b) of 86 Ill. Adm. Code 130.2115 states in part:

1) The seller of a special machine, tool, die, jig, pattern, gauge or other similar item is engaged primarily in a service occupation, rather than in the business of selling tangible personal property, and so does not incur Retailers' Occupation Tax liability with respect to the sale, if the following tests for exemption are all met in the transaction:

A) The purchaser employs the seller primarily for his engineering or other scientific skill to design and produce the property on special order for the purchaser and to meet the particular needs of the purchaser;

B) the property has use or value only for the specific purpose for which it is produced, and

C) the property has use or value only to the purchaser.

*

*

*

3) If the item qualifies for Retailer's Occupation Tax exemption under this Section, such exemption is not lost merely because the seller subcontracts the service work to someone else as long as the seller is contractually responsible to see that the necessary service work is provided.

We note the PLANT project includes the installation of Static VAR (Volt Ampere Reactive) Compensators (SVCs) for the Reserve Auxiliary Transformer (RAT) and Emergency Reserve Auxiliary Transformer (ERAT). The project was to be overseen by NAME who was to provide project management, engineering and procurement. BUSINESS was to provide the major equipment for the SVCs, RAT and ERAT. NAME was to serve as COMPANY's agent for the procurement of the BUSINESS equipment. TITLE was to perform the construction for the plant modifications.

Our review of the documents shows that BUSINESS performed studies and technical reviews for the scope, schedule and cost of the SVCs, and to size and design the SVCs. BUSINESS was

August 4, 2000

retained to work on system design, station layout, civil design and major equipment specifications. BUSINESS's scope of supply for the CITY PROJECT included BUSINESS providing system and project engineering, SVC layout and bus design, foundation design, grounding design, cable trench design and conduit routing design. The air core reactors and capacitors for the two SVCs for the RAT and ERAT systems were to be project specific. The staging of the SVCs, RAT and ERAT were to be under BUSINESS's technical direction.

We conclude the documents show that BUSINESS was hired by COMPANY to devise and develop the SVC equipment because of its design and engineering expertise in this area. The SVC equipment was to be produced for a specific use by COMPANY and at time of sale would only have value to COMPANY. Based upon this we conclude that BUSINESS's sale of the SVC equipment to COMPANY qualifies as a special order transaction taxable under the Service Occupation and Service Use Tax Acts.

Although some standard "off the shelf" parts were to be used in the SVC, this fact does not disqualify an assembly from qualifying for special order status, Section 130.2115(b)(5). While BUSINESS was to coordinate the production of the SVC equipment with NAME, the documents show that BUSINESS was required to make a substantial contribution to the designing of the SVC equipment. See 86 Ill. Adm. Code 130.2115(b)(2).

The facts upon which this ruling are based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

I hope this information is helpful. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Karl W. Betz
Associate Counsel

KWB: msk
Enc.